

Message Text

CONFIDENTIAL

PAGE 01 ROME 16241 01 OF 02 072028Z

42

ACTION EB-03

INFO OCT-01 SS-14 ISO-00 NSC-05 NSCE-00 EUR-08 INR-05

CIAE-00 DODE-00 ACDA-10 PM-03 SP-02 /051 W

----- 051091

P 071905Z NOV 75

FM AMEMBASSY ROME

TO SECSTATE WASHDC PRIORITY 4077

C O N F I D E N T I A L SECTION 1 OF 2 ROME 16241

LIMDIS

E.O. 11652: GDS

TAGS: ENGR

SUBJ: U.S.-ITALY BILATERAL ENERGY WORKING GROUP (EWG): FINANCIAL
ASPECTS OF ITALIAN NUCLEAR PLAN

REF: (A) STATE 254116

(B) ROME 15861

(C) ROME 15455

(D) ROME DS-4 DATED OCTOBER 24

SUMMARY: IN PREPARATION TO PROPOSED VISIT OF GOI FINANCIAL
EXPERT, AND IN RESPONSE QUESTIONS RAISED REF A, EMBASSY
TRANSMITS ITS ANALYSIS AND COMMENTS ON GOI NUCLEAR PROGRAM AND
US ROLE THEREIN. EMBASSY SEES SUBSTANTIAL DIFFICULTIES WITH
REALIZATION OF ITALIAN NUCLEAR PROGRAM AS PRESENTLY CONCEIVED.
HOWEVER, GOI DOES TAKE SERIOUSLY BOTH NUCLEAR PROGRAM AND NEED
FOR FOREIGN SUPPORT, VIEWING PROGRAM AS A COUNTERPART TO
ITALIAN SUPPORT FOR PETROLEUM-CONSUMER COUNTRY COOPERATION.
END SUMMARY.

1. RATIONALE: ITALIAN'S DESIRES THAT COST DIFFERENCE BETWEEN
ALL-NUCLEAR AND PART-NUCLEAR PROGRAM BE BORNE BY NON-
ITALIAN SOURCES AS CONTRIBUTION TO OVERALL CONSUMER SOLIDARITY
MAY BE OPEN TO QUESTION (WHETHER OR NOT GOI NUCLEAR PROGRAMS
CAN BE FINANCED FROM EUROPEAN OR DOMESTIC ITALIAN SOURCES
SEEMS, TO EMBASSY? DISTINCT FROM QUESTION OF RATIONALE).

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PAGE 02 ROME 16241 01 OF 02 072028Z

NEVERTHELESS, GOI CLEARLY VIEWS THE NUCLEAR PROGRAM AS (A)

THE CONCRETE EXPRESSION OF ITALIAN COMMITMENTS TO THE DEVELOPMENT OF ALTERNATIVE ENERGY SOURCES, (B) THE PRICE OF ITALIAN CONCESSIONS IN THE IEA AND ELSEWHERE, AND (C) A TEST OF US AND OTHER IEA COUNTRIES' COMMITMENT TO SUPPORTING A BALANCING BETWEEN COSTS AND BENEFITS OF CONSUMER COOPERATION AS BETWEEN ALTERNATIVE ENERGY HAVE-NOTS (ITALY) AND HAVES (MOST OTHERS). PROPOSED US CONTRIBUTION OF \$3.4 BILLION TO COVER COST DIFFERENTIAL BETWEEN ALL-NUCLEAR AND PART-NUCLEAR PROGRAM IS INDEPENDENTLY CALCULATED FIGURE; I.E., IT IS NOT INTEGRAL PART OF ANY OVERALL FINANCIAL PLAN. IN FACT, WE STILL HAVE SOME DIFFICULTY IN RECONCILING FIGURES FOR TOTAL INVESTMENT NEEDS AGAINST BREAKDOWN OF CORRESPONDING SOURCES OF FINANCING, E.G. TARIFF RATE INCREASES, CAPITAL ENDOWMENT FUND APPROPRIATIONS, AND DOMESTIC AND FOREIGN BORROWING. DESPITE GOI FIRM ATTACHMENT TO PRINCIPLE OF FOREIGN SUPPORT, \$3.4 BILLION FIGURE PROBABLY ESTABLISHES BENCHMARK FOR DISCUSSIONS, AND IS NOT RPT NOT GOI FINAL REQUEST.

2. ENEL FINANCIAL SITUATION: IN EMBASSY'S OPINION, PROBABILITY OF ALLEVIATING ENEL'S FINANCIAL SITUATION TO EXTENT PLANNED ARE SLIM. CHANCES FOR ENACTING PROPOSED RATE INCREASES ARE PARTICULARLY LOW; FOR INCREASING ENEL'S CAPITAL ENDOWMENT FUND, IN THE AMOUNTS PLANNED, SOMEWHAT BETTER. MAJOR IMPEDIMENTS ARE POLITICAL: HIKES IN OTHER PUBLIC UTILITIES RATES, SUCH AS TELEPHONES AND GAS, COUPLED WITH EXPECTED PRICE INCREASES FOR GASOLINE AND FUEL OIL, HAVE AROUSED WIDESPREAD COMPLAINTS AND IN SOME CASES VIOLENCE. LABOR CONFEDERATIONS HAVE ALREADY EXPRESSED ANTIPATHY TO PROPOSED ENEL RATE INCREASE SET OUT IN AS YET UNAPPROVED NATIONAL ENERGY PLAN. PRESENT GOVERNMENT IS WEAK AND, ALREADY LOOKING TOWARDS GENERAL ELECTIONS IN 1977, IS UNLIKELY TO ALIENATE ANY SECTOR OF VOTING POPULATION WITH HIGHLY-UNPOPULAR RATE INCREASE. ON THE OTHER HAND, ENEL FINANCIAL SITUATION IS PRECARIOUS (DESCRIBED PAGE 13 AND SUBSEQUENTLY IN DEPARTMENT'S TRANSLATION OF NATIONAL ENERGY PROGRAM-LS NO. 50811). AS WELL, ENEL CAN NO LONGER POSTPONE CONSTRUCTION OF ELECTRICAL GENERATING CAPACITY, NUCLEAR AS WELL AS NON-NUCLEAR, IF FORECAST ELECTRICITY SHORTAGES IN 1978-79 ARE NOT TO BE PERMANENT FEATURE IN LATER YEARS.

3. INCREMENTAL COST/FINANCING: FOLLOWING SHOWS DATA ON RECENT
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PAGE 03 ROME 16241 01 OF 02 072028Z

LEVEL ON ENEL BOND ISSUED (TABLE 1) AND SIZE OF ITALIAN BOND MARKET FOR BEW ISSUES (TABLE 2).

TABLE: ENEL BOND ISSUES (BILLION LIRE)

YEAR	GORSS ISSUES	NET#	OUTSTANDING AT YEAR-END
1961-70 (AVG)	287	249	
1971	680	546	3,242

1972	850	701	3,979
1973	650	483	4,483
1974	519	336	4,838
1971-74 TOTAL	2,699	2,066	

TABLE 2: ITALIAN BOND MARKET (BILLION LIRE)

YEAR	GROSS ISSUES	NET# YEAR-END	OUTSTANDING AT YEAR-END
1961-70 (AVG)	3,032	2,099	
1971	7,143	5,034	11,837
1972	8,088	5,970	12,698
1973	13,270	10,476	13,871
1974	6,726	3,473	14,600
1971-74 TOTAL	35,227	24,953	

#NET EQUALS GROSS MINUS REPACEMENT AND AMORTIZATION.

SOURCE: BANK OF ITALY ANNUAL REPORT - 1974. APPENDIX

ENEL ESTIMATES ITS TOTAL REQUIREMENTS FOR FINANCING (CAPITAL CONSTRUCTION, OPERATING, REFINANCING, ETC.) FROM DOMESTIC AND FOREIGN FINANCIAL MARKETS DURING 1975-79 AT 7,200 BILLION LIRE. (IF NO CORRECTIVE MEASURES ARE TAKEN, E.G. RATE INCREASES, NEW ENDOWMENT FUNDS, ETC., TOTAL DEMAND ON MARKETS WOULD BE 13,100 BILLION LIRE). EVEN LOWER FIGURE US ENORMOUSLY GREATER THAN ENEL'S PAST LEVEL OF BORROWING IN DOMESTIC BOND MARKET. PART OF THIS FINANCING NEED COULD PRESUMABLY BE MET FROM FOREIGN MARKETS. HOWEVER, ANY REALISTIC ASSUMPTIONS ABOUT AVAILABILITY OF FOREIGN FINANCING WOULD STILL LEAVE LARGE RESIDUAL FINANCING DEMAND ON DOMESTIC BOND MARKET CONSIDERABLY IN EXCESS OF RECENT HISTORICAL LEVELS OF ENEL BORROWING. ALTHOUGH TOTAL DOMESTIC BOND MARKET SIZE IS QUITE LARGE AND GROWTH RATE RATHER SUBSTANTIAL

CONFIDENTIAL

PAGE 04 ROME 16241 01 OF 02 072028Z

(TABLE 2), IT WILL BE DIFFICULT TO MARKET ENEL REQUIREMENTS IN THE RANGE ESTIMATED. IN THIS CONNECTION, ENEL'S 1974 ANNUAL REPORT NOTES THAT DECREASE IN BOND MARKET FINANCING OBTAINED IN 1974 WAS DUE TO FAILURE OF MARKET TO ABSORB AN ENEL INDEXED BOND ISSUE WHICH YIELDED ONLY 133 BILLION LIRE OF ORIGINALLY PLANNED 400 BILLION LIRE. CONSEQUENTLY, ENEL'S SHORT-TERM DEBT INCREASED BY 362 BILLION LIRE. MARKETABILITY OF ENEL BONDS IS INFLUENCED AS WELL BY ENEL FINANCIAL CREDITWORTHINESS, WHICH IS IN TURN DEPENDENT UPON GOI ACTION (SEE PARA 2 ABOVE).

4. WE BELIEVE THAT GOI REFERENCES TO FOREIGN FINANCING IMPLICITLY INCLUDE RESPONSE TO EUROMARKET BORROWING. TO SOME EXTENT THESE MIGHT BE THROUGH U.S. BANKS ACTIVE IN THAT MARKET; HOWEVER, PLACEMENT WITH EUROPEAN BANKS IN LONDON COULD RESULT IN SOME ADDITIONALITY IN SOURCES OF FINANCING. APART FROM ABSORPTIVE

CAPACITY QUESTION OF EUROMARKET IN COMING YEARS DUE TO RISE IN DEMAND FOR ENERGY AND OTHER INVESTMENT NEEDS, CREDITWORTHINESS QUESTION MENTIONED ABOVE WOULD ALSO BE IMPORTANT LIMITING FACTOR BOTH AS REGARDS ENEL'S OWN FINANCIAL SITUATION AND AS REGARDS ITALY'S BALANCE OF PAYMENTS PROSPECTS.

5. BASED ON ANALYSIS PARA 3 AND 4 ABOVE, EMBASSY BELIEVES THAT ENEL WOULD ENCOUNTER VERY SEVERE DIFFICULTIES ATTEMPTING TO MEET REQUIREMENTS BASED ONLY ON DOMESTIC AND EUROPEAN FINANCING, I.E. WITHOUT US ASSISTANCE. TO SOME EXTENT, PROBLEM MAY BE OVERSOME WITH SUITABLE GUARANTEES; HOWEVER, GOI IS ONLY NOW

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PAGE 01 ROME 16241 02 OF 02 072102Z

63

ACTION EB-03

INFO OCT-01 SS-14 ISO-00 NSC-05 NSCE-00 EUR-08 INR-05

CIAE-00 DODE-00 ACDA-10 PM-03 SP-02 /051 W

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P 071905Z NOV 75

FM AMEMBASSY ROME

TO SECSTATE WASHDC PRIORITY 4078

C O N F I D E N T I A L SECTION 2 OF 2 ROME 16241

LIMDIS

E. O. 11652: GDS

TAGS: ENGER

SUBJ: U.S.-ITALY BILATERAL ENERGY WORKING GROUP (EWG): FINANCIAL ASPECTS OF ITALIAN NUCLEAR PLAN

BEGINNING TO FOCUS SERIOUSLY ON THIS PROBLEM.

6. US CAPITAL, SOURCES MIX, TIMING: EMBASSY SUSPECTS THAT GOI HAS NOT FOCUSED ON SOURCES OF PRIVATE U.S. CAPITAL, PRIVATE U.S. VS PUBLIC US LENDERS AND/OR TOMING. DURING VISIT OF EXIM EXECUTIVE VP TUTINO (SUMMARIZED PARA 7 BELOW), EXIM BANK CO-LLABORATION WITH BANK AND NON-BANK FINANCIAL INSTITUTIONS TO FINANCE NON-U.S. EXPORT PORTION NOTED WHICH MAY HAVE CONTRIBUTED TO ITALIAN UNDERSTANDING IN THIS AREA. NEVERTHELESS, EMBASSY BELIEVES THAT ITALIANS WILL WISH TO EXPLORE THESE AREAS DURING

UPCOMING FINANCIAL DELEGATION VISIT PROPOSED FOR LATE-NOVEMBER. TIMING, OF COURSE, DEPENDS ON ORDERING AND CONSTRUCTION SCHEDULES WHICH ARE NOT AS YET FINALIZED.

7. TUTINO VISIT: DURING OCTOBER 23-25 VISIT, EXIM BANK EXECUTIVE VICE PRESIDENT TUTINO REVIEWED AND CLARIFIED EXIM PARTICIPATION IN FINANCING ITALIAN NUCLEAR PROGRAM DURING DISCUSSIONS WITH MFA REP MIGLIUOLO, TREASURY MINISTER COLOMBO AND DIRECTOR GENERAL PALUMBO AND IMI PRESIDENT CAPPON. TUTINO EMPHASIZED CONTINUING USG SUPPORT FOR AND WILLINGNESS TO ASSIST IN FINANCING GOI NUCLEAR PROGRAM. HE ALSO NOTED (A) THAT GOI SHOULD CAREFULLY SET CONFIDENTIAL

CONFIDENTIAL

PAGE 02 ROME 16241 02 OF 02 072102Z

OUT ALL FINANCIAL ASPECTS OF THE NUCLEAR PROGRAM PRIOR TO REVIEW WITH US AUTHORITIES; (B) EXIM BANK LIMITATIONS BARRING LEADERSHIP IN ASSEMBLING FINANCING CONSORTIA AS CONTEMPLATED BY GOI; (C) NEED TO CONSIDER POSSIBILITY OF GOVERNMENT GUARANTEES, SINCE ENEL OF IMI GUARANTEES UNLIKELY TO BE SUFFICIENT; (D) PRIVATE BANK FINANCING DIFFICULTIES DUE TO LENGTH OF MATURITIES NECESSARY; AND (E) EXIM BANK COLLABORATION WITH NON-BANK FINANCIAL INSTITUTIONS (SEE REF B). TUTINO AGAIN NOTED THAT EXIM BANK DIRECT ROLE IS LIMITED TO FINANCING US EXPORT COMPONENT. TUTINO'S POINTS WERE RECEIVED WITH INTEREST AND PROPOSED ITALIAN FINANCIAL DELEGATION VISIT IN LATE NOVEMBER WAS DISCUSSED WITH MFA AND TREASURY AS NEXT STEP TO DISCUSSING POINTS RAISED BY TUTINO. MEMCONS ON ALL THREE CONVERSATIONS HAVE BEEN POUCHED.

8. OVERALL CONSIDERATIONS: MORE FUNDAMENTALLY QUESTIONABLE IS VIABILITY OF THE 20,00 MW NUCLEAR PLAN. AS NOTED IN EMBASSY REPORTING, NUCLEAR PROGRAM IS PART OF NATIONAL ENERGY PLAN, CURRENTLY BEFORE INTER-MINISTERIAL COMMITTEE FOR ECONOMIC PLANNING (CIPE). PLAN HAS BEEN UNDER CONSIDERATION BY CIPE FOR SEVERAL MONTHS WITHOUT DISCUSSION. FURTHER, CIPE APPROVAL IS ONLY FIRST HURDLE: PUBLIC EXPENDITURES AND SOME OTHER ASPECTS WILL REQUIRE PARLIAMENTARY CONSIDERATION. EMBASSY HAS NO ASSURANCES THAT EVEN IF PLAN IS APPROVED INTACT, AS MIGLIUOLO HAS ASSURED US ON SEVERAL OCCASIONS, GOI WILL SUCCEED IN ENACTING LEGISLATION PROVIDING FOR BUDGET ALLOCATIONS FOR NUCLEAR PROGRAM AND FOR FINANCIAL RESTRUCTURING FOR ENEL. BASIC APPROVAL ASIDE, EMBASSY SEES FURTHER UNRESOLVED PROBLEMS CONCERNING IMPLEMENTATION OF THE NUCLEAR PLAN. PASSAGE OF THE NATIONAL ENERGY PLAN WILL NOT RESOLVE FINANCING PROBLEM, FOR INSTANCE. IN ADDITION, THERE ARE SERIOUS PROBLEMS RELATED TO SITING OF NUCLEAR PLANTS AND DIVISION OF EQUIPMENT ORDERS AMONG DOMESTIC AND FOREIGN COMPANIES. FORMER PROBLEM AFFECTS CONVENTIONAL GENERATING CAPACITY AS WELL AS NUCLEAR; NEEDLESS TO SAY, SITING HAS PROVED SINGULARLY INTRACTABLE TO LEGISLATIVE REMEDY IN THE PAST. EN EMBASSY FORESEES NO DIMINUTION IN LOCAL OPPOSITION. RE DIVISION OF ORDERS AMONG COMPETING COMPANIES, NEWSPAPER REPORTS SUGGEST INTENSE INFIGHTING FOR NUCLEAR PROGRAM PLUMS. IN ADDITION TO FRONT-RUNNERS

WESTINGHOUSE AND GENERAL ELECTRIC-LED CONSORTIA, SPIN (BAB-COCK AND WILCOX, GOI-OWNED FINMECCANICA) AND CANADIAN CANDU TECHNOLOGIES HAVE ENTERED THE RACE. ALL OF THIS NEEDS TO BE SORTED OUT PRIOR TO ISSUING ORDERS FOR ADDITIONAL CAPACITY.
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PAGE 03 ROME 16241 02 OF 02 072102Z

THIS WILL CERTAINLY DELAY PLANNED IMPLEMENTATION WELL BEYOND TIME FRAME FORESEEN.

9. IN FINAL ANALYSIS, BY CONCENTRATING ON US CONTRIBUTION, GOI MAY BE PUTTING THE CART BEFORE THE HORSE. WHILE THIS SHOULD NOT RPT NOT HINDER OR DIMISH OUR APPARENT FORTHCOMINGNESS, WE SHOULD BE WELL AWARE THAT GOI HAS MUCH TO DO TO PUT ITS OWN HOUSE IN ORDER.CALINGAERT

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Message Attributes

Automatic Decaptioning: Z
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: NUCLEAR ENERGY, DEVELOPMENT FINANCE, PROGRAMS (PROJECTS), LOANS
Control Number: n/a
Copy: SINGLE
Draft Date: 07 NOV 1975
Decaption Date: 28 MAY 2004
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: CunninFX
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975ROME16241
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D750388-0367
From: ROME
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19751163/aaaacekh.tel
Line Count: 295
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EB
Original Classification: CONFIDENTIAL
Original Handling Restrictions: LIMDIS
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 6
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: LIMDIS
Reference: 75 STATE 254116
Review Action: RELEASED, APPROVED
Review Authority: CunninFX
Review Comment: n/a
Review Content Flags:
Review Date: 04 JUN 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <04 JUN 2003 by ShawDG>; APPROVED <17 OCT 2003 by CunninFX>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
06 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: U.S.-ITALY BILATERAL ENERGY WORKING GROUP (EWG): FINANCIAL ASPECTS OF ITALIAN NUCLEAR PLAN
TAGS: ENRG, EFIN, US
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 06 JUL 2006